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OCT 11 1935

No. 17

In the Supreme Court of the United States

OCTOBER TERM, 1935

T. A. MORRISSEY AND JAMES M. O'BRIEN, TRUSTEES OF AN EXPRESS TRUST KNOWN AS WESTERN AVENUE GOLF CLUB, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

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No. 17

T. A. MORRISSEY AND JAMES M. O'BRIEN, TRUSTEES of an Express Trust Known as Western Avenue Golf Club, petitioners

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. I, 31–51) is unreported. The opinion of the Circuit Court of Appeals (R. I, 67–72) is reported in 74 F. (2d) 803.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 7, 1935 (R. I, 73). A petition

for rehearing was denied March 1, 1935 (R. I, 74). Petition for a writ of certiorari was filed April 1, 1935, and was granted May 13, 1935 (R. II, 41). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the trust involved is an association within the meaning of Section 2 (a) (2) of the Revenue Acts of 1924 and 1926.

2. Whether Section 704 (a) of the Revenue Act of 1928 prevents the trust involved from being regarded as an association for the year 1924.[1]

STATUTES AND OTHER AUTHORITIES INVOLVED

The statutes and other authorities involved are set out in Appendix A, *infra*, pp. 35–46.

STATEMENT

The following facts are taken from the stipulation of facts (R. I, 22–31), from the Board's opinion (R. I, 31–51) and from the trust instrument (R. II, 1–37).

On October 4, 1921, T. A. Morrissey and James M. O'Brien executed a declaration of trust by which they declared that they held a certain parcel of real estate in Los Angeles, California, consisting of 155 acres in trust. (R. I, 33; R. II, 1.)

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[1] This question was not raised in the petition for writ of certiorari, but is discussed in the petitioner's brief on the merits.

The trust instrument directed that they should hold that property and any other property thereafter conveyed to them as trustees in trust to collect, receive, hold and distribute the net income thereof for the benefit of those holding certificates of beneficial interest. The trustees were also authorized to buy, sell, lease and mortgage real estate, to farm, to construct or acquire and operate golf courses, tennis courts, swimming pools, bowling alleys and club houses and stores, shops and cafes and other businesses in connection therewith. Broad powers of management were given to them in the exercise of these powers. (R. II, 1–14.)

The trust was to be called the "Western Avenue Golf Club" and was to exist for twenty-five years, unless the trustees themselves should elect to terminate it before that time. (R. II, 2, 31.)

The trustees were empowered to increase their number and to elect successor trustees by a majority vote. They were also authorized to appoint an advisory board, an executive committee and officers, but the appointment of the advisory board was not to limit the powers of the trustees. (R. II, 2–3, 11–12.)

Neither the trustees nor the directors, executive committee or officers were to be personally liable for any obligations of the trust, the trust fund being the sole source of reimbursement or payment. (R. II, 15–16.)

There were to be two thousand preferred shares of beneficial interest of a par value of $100 a share

and an equal number of common shares of no par value. The latter were subject to assessments. (R. II, 19, 25–26.)

The preferred certificate holders were entitled to a fixed dividend and the common certificate holders to such dividends as the trustees declared. (R. II, 19–20.)

The trust instrument provided that neither class of certificate holders should have any rights different from those of *cestui que trustent*. (R. II, 30.)

During the years 1921 and 1922 the trustees sold beneficial interests in the trust, paying $5,692.90 and $5,036.15 to salesmen in commissions on the sales. (R. I, 36.)

About 42 acres of the land constituting the trust corpus was subdivided into lots in December, 1921. Improvements were made and all of the lots were sold in 1922, 1923 and 1924. (R. I, 26.)

On that part of the property not subdivided, a golf course and club house were built in 1922. The club was open only to the beneficiaries and other members and their guests. Greens fees were charged and the dining room and golf supplies department were operated by concessionaires on a percentage basis. (R. I, 26–27.)

In July 1923 the land comprising the golf course, with other improvements, was conveyed to a corporation known as Western Avenue Golf Club, Incorporated, in exchange for its stock.

Thereafter until January 12, 1924, the trust operated it under a lease. (R. I. 39–40.)

Collections of installment payments on the contracts for the sale of lots were made during 1921 to 1926 by a bank as agent. Since January 12, 1924, the trust's activities have consisted of collections on lots, collection of interest payments on bank balances and dividends on stock, receipt of assignment fees in assignment of lot purchase contracts by holders, execution of conveyances and the distribution of moneys. (R. I, 41–42.)

During the years 1922 to 1926, inclusive, the trustees owned from 15.8% to 42.4% of the beneficial interest. (R. I, 43.) From 275 to 920 persons held interests at various times. (R. I, 31.)

The trust filed returns as a trust for the years 1921 to 1926, inclusive. The Commissioner determined that it was an association and asserted deficiencies. The Board sustained the Commissioner's determination for the years 1924, 1925 and 1926,[2] which are the taxable years here involved, and the Circuit Court of Appeals affirmed the Board's decision.

SUMMARY OF ARGUMENT

The decisions of this Court establish that some organizations which are trusts in form may be treated as associations for Federal tax purposes and taxed as corporations, and that a trust may be

[2] There were other issues involved before the Board which are not before this Court.

an association regardless of whether the beneficiaries have control. The decisions of the Circuit Courts of Appeals are to the same effect, although they differ as to what is the proper test.

Since associations are by the statute assimilated to corporations, the problem is to determine what features associations have in common with corporations which led to this classification. The question is complicated by the fact that all associations have features which are common to those trusts separately taxed under Section 219, and the need for drawing a distinction between them. We think that the distinction between associations and the trusts taxed under Section 219 is the distinction between business trusts on the one side and on the other trusts which are engaged merely in collecting the income and conserving the property against the day when it is to be distributed to the beneficiaries. We submit that Congress intended that all business trusts should be taxed as associations, and hence that the "doing business" test which is emphasized by many decisions is the single criterion on which this case should depend.

Some courts have held that the activities in which the organization is engaged are not the sole test, but that the qualities and characteristics of the organization must likewise be examined in order to determine whether classification as a corporation is justified. However, the courts holding this view differ widely in the relative importance

to be given to matters of substance and matters of form. In some decisions such incidental features as seals, officers, meetings, etc., are magnified in importance, while other cases hold that the necessary similitude is to be found if the organization has the substantial qualities of a corporation, such as centralized control, continuity, and limited liability. If it is necessary to have regard for anything more than the activities of the organization and doing business is not the sole test, we think that an organization which does business and enjoys the substantial advantages of centralized control, continuity, and limited liability is an association within the meaning of the statute. Applying either test, the trust here involved is properly classified as an association.

It is our position that the decisions of this Court establish that a trust is an association, when it is engaged in doing business.

Treasury regulations to this effect were promulgated under the Revenue Acts of 1924 and 1926 after pertinent decisions of this Court were rendered.

Section 704 (a) of the Revenue Act of 1924 has no application to the case, since the regulations were changed to eliminate the necessity of beneficiary control prior to the time that the trust filed its return as a trust for 1924.

No double taxation is involved in taxing the trust as a corporation even if it receives dividends from

another corporation. These dividends would not be taxed to the association under the statutes here involved, and when distributed to individual certificate holders as its dividends would only be subject to surtax in their hands, just as the earnings of any corporation are subject to a corporate tax and then to surtax when distributed to individual stockholders.

ARGUMENT

I

THE WESTERN AVENUE GOLF CLUB WAS AN ASSOCIATION WITHIN THE MEANING OF SECTION 2 (A) (2) OF THE REVENUE ACTS OF 1924 AND 1926

The chief question is whether the trust involved is an association within the meaning of Section 2 (a) (2) of the Revenue Acts of 1924 and 1926 and hence is to be taxed as a corporation, or is a pure trust which by virtue of Section 219 of those Acts is taxed as an individual.

The statutes involved do not define the term "association" or provide a rule for distinguishing between trusts which are to be taxed as trusts and those which were to be treated as associations, but they do indicate very clearly that the trusts to be treated as pure trusts under Section 219 are those organized and engaged solely to hold or conserve property.

That all organizations which are trusts in form are not to be so treated for tax purposes is settled

by the decisions of this Court in *Crocker* v. *Malley*, 249 U. S. 223, and *Hecht* v. *Malley*, 265 U. S. 144, although in neither case was an all-embracing definition of the word "association" adopted.

The case of *Crocker* v. *Malley* involved taxes imposed under the Revenue Act of 1913 upon the income of "every corporation, joint-stock company or association". That statute, however, did not contain any provisions indicating the classes of trusts[1] to be taxed as individuals such as are incorporated in Section 219 of the Revenue Acts of 1924 and 1926, *infra*. The trust in that case had been formed by a Maine corporation which had been engaged in the manufacture of paper. Seven of the mills which it owned and operated in Massachusetts had been transferred to a Massachusetts corporation in exchange for stock and the eighth had been leased to the latter on a long term lease. The Maine corporation transferred the fee of the eighth mill to certain individuals in trust, left the stock of the Massachusetts corporation in their hands for the time being, though it was possible that the Maine company shareholders might have demanded it, and was dissolved.

The declaration of trust directed the trustees to hold the real estate and other property received, to convert it into money and distribute it to the holders of beneficial interest in the trust. The trust was stated to be for the benefit of the eight share-

[1] See Section II B and D.

holders of the Maine corporation and its purpose that of permitting dissolution before final distribution of assets; although the trustees had power to acquire other property. The beneficiaries' consent was required in filling vacancies among the trustees and in providing for the compensation of the trustees and in modifying the trust. The trust was known as "The Massachusetts Realty Trust".

This Court held that the trust in question was not an association. In so holding, the Court recognized that the case was not necessarily controlled by the fact that the trust was regarded as a trust in Massachusetts, where organized, but concluded that the trust was a pure trust because the beneficiaries had no control. The Court, however, was clearly influenced in its decision by the use of the phrase "joint-stock companies or associations" in the statute there involved and by the fact that to have held the trust a corporation would have resulted in a double tax on corporate dividends, since the corporation paying them was taxed on its earnings and the statute there involved taxed a corporation on dividends received from other corporations.

The trust agreement involved in that case with modifications and two other Massachusetts real estate trusts were before this Court in *Hecht* v. *Malley*, 265 U. S. 144, *supra*, where the question was whether they were subject to capital stock tax imposed by Section 1000 of the Revenue Act of 1918 and also to another excise tax imposed on cor-

porations by the Revenue Act of 1916. Under the Revenue Act of 1918, as under the Revenue Act of 1924, the term "corporation" was defined to include associations instead of the tax being imposed in terms "corporations, joint-stock companies or associations" as under the 1913 Act, and the same definition was made applicable to the capital stock tax and the income tax.

The Court determined that the *Crocker* trust had been modified so as to transfer the assets of the business to the trust and authorize the trustees to carry on business and to enable the certificate holders to remove any trustee. It held that regardless of control by the beneficiaries, that trust, as well as the other trusts involved, were associations under the Revenue Act of 1918.

In doing so the Court rejected the argument that the *Crocker case, supra,* had conclusively determined that a Massachusetts trust could not be an association without beneficiary control, and said (pp. 160–161):

> This opinion is based primarily upon the view that the Income Tax Act, considering its purpose, did not show a clear intention to impose upon the trustees as an "association" a double liability in reference to the dividends on stock in the corporation that itself paid an income tax, when considered as "trustees" they were by another provision of the Act exempt from such payment. And the language used *arguendo* in reaching this

conclusion that the trustees could not be deemed an association unless all trustees with discretionary powers are such, and that there was no ground for grouping together the beneficiaries and trustees in order to turn them into an association—is to be read in the light of the trust agreement there involved, under which the trustees were, in substance, merely holding property for the collection of the income and its distribution among the beneficiaries, and were not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business. *Zonne* v. *Minneapolis Syndicate,* 220 U. S. 187, 190. And see *Smith* v. *Anderson,* L. R., 15 Ch. Div. 247.

It results that *Crocker* v. *Malley* is not an authority for the broad proposition that under an Act imposing an excise tax upon the privilege of carrying on a business, a Massachusetts Trust engaged in the carrying on of business in a quasi-corporate form, in which the trustees have similar or greater powers than the directors in a corporation, is not an "association" within the meaning of its provisions.

We conclude, therefore, that when the nature of the three trusts here involved is considered, as the petitioners are not merely trustees for collecting funds and paying them over, but are associated together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises, the trusts are to be

deemed associations within the meaning of the Act of 1918; this being true independently of the large measure of control exercised by the beneficiaries in the *Hecht* and *Haymarket* cases, which much exceeds that exercised by the beneficiaries under the Wachusett Trust. We do not believe that it was intended that organizations of this character—described as "associations" by the Massachusetts statutes and subject to duties and liabilities as such—should be exempt from the excise tax on the privilege of carrying on their business merely because such a slight measure of control may be vested in the beneficiaries that they might be deemed strict trusts within the rule established by the Massachusetts courts.

It is our position that the decision in *Hecht* v. *Malley, supra,* determined that a trust under which a combination of persons were doing business would be an association irrespective of beneficiary control and, in the alternative, that if that decision made the further requirement that the trust must resemble a corporation, this requirement was simply that the trust should have the attributes of a corporation such as centralized control, continuity of existence, and limited liability, regardless of forms used in effecting them.

The courts and the regulations of the Treasury Department have accepted the view that beneficiary control is no longer a requisite, except in so far as the question may be affected by Section 704

(a) of the Revenue Act of 1928, an issue discussed in Point II.

We do not believe that the petitioners seriously argue otherwise or that the point requires extended consideration here. The petitioners do suggest that the decision in *Crocker* v. *Malley, supra,* is entitled to greater weight than *Hecht* v. *Malley, supra,* because the former was an income-tax case and the latter a capital-stock case. But Section 2 of the Revenue Act of 1918 involved in *Hecht* v. *Malley, supra,* and of the Revenue Acts of 1924 and 1926, *infra,* here involved, give a single definition of the word "corporation" to be used throughout the statute in imposing both taxes, so that this contention is without merit. The courts generally have considered that *Hecht* v. *Malley* controlled. See *Little Four Oil & Gas Co.* v. *Lewellyn,* 35 F. (2d) 149 (C. C. A. 3d), certiorari denied, 280 U. S. 613; *Gray* v. *Hopkins,* 68 F. (2d) 561 (C. C. A. 5th; certiorari denied, 292 U. S. 643; *Ittleson* v. *Anderson,* 67 F. (2d) 323 (C. C. A. 2d); *Dunbar* v. *Commissioner,* 65 F. (2d) 447 (C. C. A. 1st); *Twin Bell Oil Syndicate* v. *Helvering,* 70 F. (2d) 402 (C. C. A. 9th), reversed on other grounds, 293 U. S. 312.

The regulations issued by the Treasury Department likewise have assumed that *Hecht* v. *Malley, supra,* controlled in income-tax cases. Following the decision in *Hecht* v. *Malley, supra,* in May 1924, the Treasury Department published the decision as a Treasury decision, and on June 7, 1924, issued T. D. 3598, III–1 Cumulative Bulletin 489, which

defined the term "association" for capital-stock tax purposes to include operating trusts of the Massachusetts type, regardless of beneficiary control. By I. T. 2061, published August 11, 1924, III–2 Cumulative Bulletin 5 (for date issued see G. C. M. 6417, VIII–1 Cumulative Bulletin 152), this ruling was made applicable to income taxes imposed under the Revenue Act of 1924 and the definition appeared in Regulations 65, promulgated under the Revenue Act of 1924, when they were issued in October, 1924. See Article 1504, *infra*.

This regulation was amended by T. D. 3748, IV–2 Cumulative Bulletin 7, *infra*, so as to provide, *inter alia*, that a trust in which the beneficiaries have control should be regarded as an association but that even in the absence of control, where the trustees are not restricted to the mere collection of funds and their distribution but are "associated together with similar or greater powers than that of directors of a corporatio for the purpose of carrying on some business en rise", the trust should be regarded as an association. On the other hand, trusts in which the trustees are merely holding property and collecting income for distribution, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of business, the trust is regarded as a pure trust and not an association.[4]

[4] It will be noted that under the regulations a trust in which the beneficiaries do control is still treated as an association on the basis of the test in *Crocker* v. *Malley*, *supra*.

Similar regulations were promulgated under the Revenue Acts of 1926, 1928 and 1932 (see Articles 1502 and 1504 of Regulations 69 and Articles 1312 and 1314 of Regulations 74 and 77, *infra*), except that in Article 1314 of Regulations 77 all reference to control by beneficiaries was eliminated. But under all of these regulations the test of engaging in business was made the paramount test, since even without beneficiary control a trust might be classified as an association if it engaged in business.

We submit that the regulations promulgated under the Revenue Acts of 1924 and 1926 are the basic regulations in this case, although for reasons we shall subsequently point out the regulations themselves may require interpretation as applied to certain situations not specifically covered by them. There is clearly no merit to the petitioners' argument that the regulations promulgated under the Revenue Acts of 1918 and 1921 control under the Revenue Acts of 1924 and 1926 because Congress reenacted the same statutory definition of corporations in the Revenue Act of 1924, after the regulations had been continued in effect for an extended period. To hold otherwise would be to say that the Commissioner cannot issue a changed regulation unless statutory provisions are changed, even when this Court has rendered a decision finding its interpretation inconsistent with the law.

See S. M. 4104, IV–2 Cumulative Bulletin 8. But trusts in which the beneficiaries have no control are regarded as associations if there is a combination of persons involved and the trust is doing business.

While we readily concede that an unchanged regulation may acquire the force and effect of law through legislative approval (*McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488; *Brewster* v. *Gage*, 280 U. S. 327; *Helvering* v. *Bliss*, 293 U. S. 144), we know of no decision which holds that the Commissioner may not issue a new regulation under a new law. Amended regulations under the same law are often given effect even as to transactions fully consummated (*Murphy Oil Co.* v. *Burnet*, 287 U. S. 299, 303–304; *Burnet* v. *S. & L. Bldg. Corp.*, 288 U. S. 406), and Section 605 of the Revenue Act of 1928 implies that regulations may be applied either retroactively or not, as the Secretary directs. See also Section 1008 of the Revenue Act of 1924 and Section 1108 of the Revenue Act of 1926.

Moreover, as to the particular statute here involved, the courts have consistently recognized that the regulations governing the year 1924 are Articles 1502 and 1504 of Regulations 65, promulgated under the Revenue Act of 1924 as amended. *Gray* v. *Hopkins, supra; Commissioner* v. *Neal*, 65 F. (2d) 761 (C. C. A. 1st), certiorari denied, 290 U. S. 675; *Dunbar* v. *Commissioner, supra; Tyson* v. *Commissioner*, 68 F. (2d) 584 (C. C. A. 7th), certiorari denied, 292 U. S. 657. See also brief of *amicus curiae*.

The regulations perhaps suggest that, in addition to the requirement for doing business, there

must be a combination of persons in management, and the rulings have generally been based on the theory of the necessity for beneficiary participation in management in cases involving a single trustee. See I. T. 2572, X–1 Cumulative Bulletin 200; G. C. M. 2405, VI–2 Cumulative Bulletin 10; S. M. 5382, V–1 Cumulative Bulletin 11. See also *Trust No. 5833, Security First Nat'l Bank* v. *Welch*, 54 F. (2d) 323, certiorari denied, 286 U. S. 544.

In *Crocker* v. *Malley, supra,* it was held that the trustees and beneficiaries together did not furnish the combination of persons necessary to an association but this Court apparently held otherwise in *Hecht* v. *Malley, supra.*

In this case there was more than one trustee engaged in management, but we think it desirable to state the Government's position that the necessary combination may exist without that factor. See Article 801–3 of Regulations 86, *infra,* promulgated under the Revenue Act of 1934, and see Section 704 (b) of the Revenue Act of 1928, *infra.* Every trust involves the combination of persons necessary to an association, regardless of whether they be combined in management. Even in a case where a single trustee is managing the business, it is his management and the capital of the beneficiary or beneficiaries that produces the profit. See *Ittleson* v. *Anderson, supra,* in which the following is stated:

> Usually there are a number of trustees and of beneficiaries in a business trust, but there is no reason to say that every business trust must have more than one trustee and more than one beneficiary at all times.

The situation is not unlike that in a certain type of limited partnerships which are treated as associations. See Article 1506 of Regulations 65 and 69. There is also an analogy to groups doing a reciprocal or similar insurance business through an attorney-in-fact which have been held to be associations. *Harris* v. *United States,* 51 F. (2d) 382 (S. D. Tex.). See also *Pickering* v. *Alyea-Nichols Co.,* 21 F. (2d) 501 (C. C. A. 7th), certiorari denied, 276 U. S. 617.

We submit, therefore, that the doing business test is the essential test under the decision of this Court in *Hecht* v. *Malley, supra* and under the regulations.

Some of the Circuit Courts of Appeals, however, have considered that *Hecht* v. *Malley, supra,* also requires that there be external resemblances to a corporation.

It is true that in that case the Court referred to a dictionary definition of an association as "a body of persons united without a charter, but upon the methods and forms used by incorporated bodies for the prosecution of some business enterprise", and that it designated the trusts there involved as "quasi-corporate" organizations, but the decision was finally made to rest upon whether the trustees

were associated together in much the same manner as directors of a corporation for the purpose of carrying on a business enterprise. Each trust was tested under this rule and found to be an association.

The Circuit Courts of Appeals for the Second and Third Circuits have consistently relied upon the business test as conclusive and that was the view of the Circuit Court of Appeals for the Ninth Circuit until its recent decision in *Commissioner* v. *Combs,* 76 F. (2d) 682, now pending before this Court on petition for a writ of certiorari, No. 238, October Term, 1935. The Circuit Court of Appeals for the First, Fifth, Seventh and Tenth Circuits have in general insisted on the test of external resemblance, although the decisions of the First and Seventh Circuits are not wholly consistent. A list of these decisions will be found in Appendix B, *infra.* No decisions have been found in the Circuit Courts of Appeals for the Fourth, Sixth and Eighth Circuits, or in the Court of Appeals for the District of Columbia, except *Burnet* v. *Burns,* 63 F. (2d) 313 (C. C. A. 8th), which is inconclusive on this question. The Circuit Court of Appeals for the First Circuit commented on the conflict of decisions in *Coleman-Gilbert Associates* v. *Commissioner,* 76 F. (2d) 191, now pending in this Court on petition for writ of certiorari, Nos. 78 and 79, October Term, 1935.

We believe that an analysis of the cases in which resemblances to a corporation have been weighed

and relied upon will show how impossible it is to make them the test. In some cases certificates of stock or a seal or formal meetings of the trustees like directors' meetings will be regarded as important, and in others not so important. For example, compare *Sears, Roebuck & Co. Employees' Savings, etc.* v. *Commissioner,* 45 F. (2d) 506 (C. C. A. 7th), where there were no certificates, and the decisions of the same court in *Tyson* v. *Commissioner, supra,* and *Reinecke* v. *Kaempfer,* 72 F. (2d) 469, certiorari denied, 294 U. S. 708, with *Commissioner* v. *Guitar Trust Estate,* 72 F. (2d) 544 (C. C. A. 5th).

We submit that in order for the various Circuit Courts of Appeals, the District Courts and the Board to achieve some degree of uniformity in their decisions, either the business test must be considered conclusive in itself or conclusive where there are some or all of the elements of centralized control, limited liability and continuity of the business regardless of death or transfers of interest and that it is not important whether the trust has certificates of stock or other external features of a corporation. See Article 801–3 of Regulations 86, *infra.*

The first alternative has the advantage of simplicity and is not inconsistent with the statute or regulations or with what this Court said in *Hecht* v. *Malley, supra.*

It should be remembered that the ordinary trust *per se* has certain corporate attributes in that ordi-

narily there is no personal liability of trustees or beneficiaries and the beneficiaries are free to dispose of their beneficial interests, regardless of whether they are represented by shares.

The enumeration of trusts in the subdivisions of Section 219 (a) of the Revenue Acts of 1924 and 1926 suggests that in enacting those provisions Congress had in mind testamentary trusts and other trusts created simply to conserve assets and collect income and pay it over or accumulate it for future distribution.

Articles 801–2 and 801–3 of Regulations 86, promulgated under the Revenue Act of 1934, *infra*, adopt this view. These regulations draw a distinction between a trust created by will or otherwise for the purpose of taking title to property and conserving it, engaging in only such activities as are required, and a trust designed to afford a medium whereby a profit-seeking activity may be carried out with some of the advantages and none of the disadvantages of a corporation. Article 801–3 points out the benefits of such an arrangement as follows:

> By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of

capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form itself.

We believe that these regulations, which do not so much depart from previous regulations as they simplify and clarify them, should be recognized as

stating the correct principles under the earlier statutes. The statutory provision was not changed. See Section 801 of the Revenue Act of 1934.

But if it is considered necessary that there be corporate attributes, we believe that the attributes which are important are those of substance and not of form, as in other fields of taxation. *United States* v. *Phellis*, 257 U. S. 156; *Weiss* v. *Stearn*, 265 U. S. 242; *Labrot* v. *Burnet*, 57 F. (2d) 413 (App. D. C.).

We submit that externals were not considered as important in *Hecht* v. *Malley, supra*. In that case this Court quoted its previous decision in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, where the Court, in sustaining an excise tax measured by income which was imposed only on corporations, stated that the tax was imposed on the doing of business with the advantages which lay in the peculiarities of corporations or joint-stock associations.

This language suggests that a trust having the substantial qualities of a corporation, such as centralized control, continuity and limited liability, should be taxed as one. Somewhat the same thought is expressed in *Reinecke* v. *Kaempfer, supra*, where the court said (pp. 470–471):

> As we pointed out in *Sears, Roebuck, etc.*, v. *Commissioner*, 45 F. (2d) 506, there are various kinds of corporations, some with and some without shares of stock; and some for and others not for pecuniary profit. And it was there held that shares of stock, or the

> equivalent, and assignable interests of beneficiaries were not essential to constitute a taxable association under the statute. The entity there involved was without shares of capital stock and without assignable interests, but it was held to be a taxable association under the act.
>
> We are satisfied that the similitude referred to is not in those essentials which distinctly stamp the entity as a corporation, but rather in the business carried on and the manner of its transaction. This entity carried on its business in substantially the same way that a corporation would have carried it on. It regularly bought and sold merchandise for the purpose of realizing profit thereon; it constituted the persons to carry on the business, and even made provision for exemption of the trustees from personal liability for trust obligations, much as in the case of business corporations.

The facts in the present case are such that the trust satisfies the doing-business test and, if more be required, it has the centralized control, continuity and limited liability of a corporation.

The trust in this case was a voluntary association of individuals who acquired 155 acres of land in Los Angeles with a view to subdividing part of it into lots and selling them at a profit and developing a golf course on the remainder. (R. I, 47.) It proceeded to accomplish those purposes. It subdivided the property, made street and other improvements and disposed of the lots at a substantial

profit during the years 1921 to 1923. It also developed the golf course as a profit-making enterprise.

The petitioners argue that because all of the lots had been sold before 1924, and the golf course was not operated by the trust after January 12, 1924, the trust was not doing business during the years 1924, 1925 and 1926, but was merely in process of liquidation.

The petitioners thus fail to distinguish between cases involving a trust which is organized for the purpose of liquidation (*White* v. *Hornblower*, 27 F. (2d) 777 (C. C. A. 1st); *Commissioner* v. *Atherton*, 50 F. (2d) 740 (C. C. A. 9th); *Blair* v. *Wilson Syndicate Trust*, 39 F. (2d) 43 (C. C. A. 5th); *Fisk* v. *United States*, 60 F. (2d) 665 (Mass.); *Commissioner* v. *Morriss R. Co. Trust No. 2*, 68 F. (2d) 648 (C. C. A. 7th); *Willis* v. *Commissioner*, 58 F. (2d) 121 (C. C. A. 9th)) and cases in which a trust organized for profit has carried out most of the activities for which it was organized except the collection of its profits.

This distinction is emphasized in *Sloan* v. *Commissioner*, 63 F. (2d) 666 (C. C. A. 9th), where the trust was organized for the purpose of leasing, mortgaging and selling lots in a subdivision but had ceased to transact any business other than the collection and distribution of installment payments. The court held that it was not to be considered as a trust merely because all of its lots had been sold.

This Court has recognized that less activity is required to hold that a corporation which was organized for profit is doing business than one organized merely to hold property and collect income. *Flint* v. *Stone Tracy Co., supra; Zonne* v. *Minneapolis Syndicate,* 220 U. S. 187; *McCoach* v. *Minehill Railway Co.,* 228 U. S. 295; *United States* v. *Emery,* 237 U. S. 28; *Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503; *Edwards* v. *Chile Copper Co.,* 270 U. S. 452. See also *Stanley Securities Co.* v. *United States,* 38 F. (2d) 907 (C. Cls.), certiorari denied, 282 U. S. 845.

The petitioners apparently consider that only a trust engaged in a merchandising business may be said to be engaged in business, and that a trust operating real estate may not. But many trusts engaged in real estate subdivision or management have been held to be associations. *Hecht* v. *Malley, supra; Sloan* v. *Commissioner, supra; Commissioner* v. *Neal,* 65 F. (2d) 761 (C. C. A. 1st), certiorari denied, 290 U. S. 675; *Tyson* v. *Commissioner, supra; Swanson* v. *Commissioner,* 76 F. (2d) 651 (C. C. A. 7th), now pending before this Court on petition for a writ of certiorari, No. 108, October Term, 1935.

If it is also required that the trust have centralized control, continuity and limited liability, or one or more of them, all of those elements are present in this case.

The trustees were given exceedingly broad powers of management and were authorized to appoint an advisory board and executive officers to act with them. (R. II, 4–13.) During the years involved in this case the trustees acted for between 275 and 920 persons. (R. I, 31.)

There was also no liability against the directors, advisory committee or officers for debts incurred by the corporation. (R. II, 15–16.) The beneficiaries holding common shares were liable for assessments but only to the extent that stockholders of a California corporation are liable. (R. II, 25–26.)

The trust was to last for twenty-five years, unless the trustees elected to terminate it before that time (R. II, 2, 31), and the beneficiaries could alienate their interests which were in the form of certificates. (R. II, 19–21, 25–26, 30.)

Accordingly, the trust had centralized control, limited liability and continuity, which are peculiar to a corporation.

We think that is all that can be required under any test. We point out in passing, however, that the trust here involved had many external resemblances to a corporation, so that even under the petitioners' construction of the statute there is justification for holding that the trust was an association under Section 2 (a) (2) of the Revenue Acts of 1924 and 1926.

The petitioners claim (Br. 20–21) that such a result would be contrary to the decision of this Court in *Senior* v. *Braden*, decided May 20, 1935, which involved an Ohio property tax. The question there was whether cetrificates of beneficial interest in certain trusts (each of which owned only one piece of real estate) represented an interest in the land itself, which could not be reached by the tax because situated outside of Ohio, or personal property. The Court pointed out that each trustee held only one piece of land and was free from control by the beneficiaries, citing *Hecht* v. *Malley, supra.*

That case was not cited as decisive of the questions here involved, but apparently as an example of one species of trusts considered by this Court to be an association. Indeed, in *Hecht* v. *Malley*, it is specifically stated:

> What other form of "associations," if any, it includes, we need not, and do not, determine.

In any event, a decision as to what constitutes an association for Federal tax purposes is not controlled by decisions under state laws. *Crocker* v. *Malley, supra; Burk-Waggoner Oil Assn.* v. *Hopkins*, 269 U. S. 110.

The petitioners also argue (Br. 15) that to classify the trust involved in this case as an association will result in the same kind of double taxation that the Court found objectionable in *Crocker* v. *Malley, supra.*

This position is wholly untenable. If the trust in this case is held to be an association, it will be taxed as a corporation at the regular rates imposed by Section 230 of the Revenue Acts of 1924 and 1926; namely, 12½% for 1924, 13% for 1925 and 13½% for 1926. It will not, however, be taxed on any dividends. Section 234 (a) (6) of the Revenue Acts of 1924 and 1926. Any distributions that it makes will be regarded as dividends and if paid to individuals will be subject to surtax but not to normal tax. See Section 216 (a) of the Revenue Acts of 1924 and 1926. If paid to a corporate beneficiary, they will not be taxed at all. Section 234 (a) (6) of the Revenue Acts of 1924 and 1926. Hence the dividends which the trust receives from other corporations and distributes to beneficiaries will not be taxed to it at all but will be subject to surtax in the hands of individual beneficiaries. Hence the corporate dividends are not taxed twice.

There is no double taxation involved in an individual paying a surtax on dividends received from a corporation which had been taxed on its earnings. *Hellmich* v. *Hellman,* 276 U. S. 233.

The situation in *Crocker* v. *Malley, supra,* was very different. As previously pointed out, under that Act a corporation was subject to tax at regular corporate rates on dividends received from another corporation, so that if the trust had been held to be an association, it would have been subject to the same kind and rate of tax on the earnings represented by any corporate dividends it received

that the corporation declaring the dividends had already paid. That situation does not arise here.

II

SECTION 704 (A) OF THE REVENUE ACT OF 1928 HAS NO APPLICATION TO THIS CASE

The petitioners argue that the trust should be treated as a pure trust for the year 1924 by virtue of Section 704 (a) of the Revenue Act of 1928.

This issue was not raised in the petition for a writ of certiorari, and we do not believe that the Court is required to pass upon it. *Webster Co.* v. *Splitdorf Co.*, 264 U. S. 463; *Gunning* v. *Cooley*, 281 U. S. 90; *Alice State Bank* v. *Houston Pasture Co.*, 247 U. S. 240.

But if the Court should consider the question, we think it clear that Section 704 (a) has no application.

That section provides in substance that where a taxpayer has filed a return for any year prior to the year 1925, it shall be taxed as a trust and not as a corporation (1) if it was regarded as a trust under regulations in effect when the return was filed, or (2) if it was regarded as a trust under any ruling of the Commissioner which had not been reversed or revoked prior to the time the return was made.

The purpose of this legislation was to permit the test of liability for taxable years prior to 1925 to be governed by regulations and rulings in effect at the time the return was made, provided a return

was filed as a trust. *Gray* v. *Hopkins*, 68 F. (2d) 561 (C. C. A. 5th), certiorari denied, 292 U. S. 643; *Sloan* v. *Commissioner*, 63 F. (2d) 666 (C. C. A. 9th); S. Rep. No. 960, 70th Cong., 1st Sess., pp. 44–45.

Under Article 1502 and Article 1504 of Regulations 62, *infra*, promulgated under the Revenue Act of 1921, it was generally assumed that a trust in which the beneficiaries had no control should be regarded as a pure trust, although the regulations are not wholly clear. *Sloan* v. *Commissioner, supra.* Hence if that regulation or rulings to the same effect had remained in force until the petitioners filed a return for 1924 as a trust, the trust should be treated as a pure trust and not as an association for the year 1924, regardless of the disposition made of the later years. It was on that basis that the Board held that the trust was a pure trust for the years 1921, 1922 and 1923. (R. I, 46–47.)

But regulations and rulings to that effect did not remain in force until the return for 1924 was filed.

The record does not show when the return for 1924 was filed, but it was not due until March 15, 1925, and could not have been filed prior to January 1, 1925.

Before either date this Court had, on May 12, 1924, decided the case of *Hecht* v. *Malley*, 265 U. S. 144, which held that a trust might be regarded as an association regardless of beneficiary control. On June 7, 1924, the Secretary of the Treasury promulgated T. D. 3598, III–1 Cumulative Bulletin

489, amending the capital stock regulations so as to omit reference to beneficiary control and to provide that operating trusts in which the trustees were not restricted to the collection of funds but were associated together in much the same manner as directors of a corporation in carrying on a business enterprise should be treated as associations.

On July 9, 1924, the Solicitor of Internal Revenue in S. M. 2291 ruled that the decision was applicable under the income-tax provisions of the Revenue Act of 1924 and this decision was published August 18, 1924, III–2 Cumulative Bulletin 6. Another ruling to the same effect, I. T. 2061, III–2 Cumulative Bulletin 5, was published August 11, 1924.

On October 6, 1924, Regulations 65 were promulgated under the Revenue Act of 1924, and Article 1504, *infra*, contained provisions similar to T. D. 3598, *infra*.

Under Article 1700 of those Regulations all rulings inconsistent therewith were revoked.

It is not necessary to consider the subsequent amendment of Articles 1502 and 1504 by T. D. 3748 and T. D. 3749, promulgated August 31, 1925, *infra*, for the reason that under those articles prior to the amendment an operating trust engaged in business would be taxed as an association, irrespective of beneficiary control.

It is clear, therefore, that there were no rulings or regulations in effect when the 1924 return was filed under which this trust would have been treated

as a pure trust because of the lack of beneficiary control. In G. C. M. 6417, VIII–1 Cumulative Bulletin 152, it was stated that August 11, 1924, should be regarded as the effective date of the change. See also *Van Cleave Trust* v. *Commissioner*, 18 B. T. A. 486.

The Circuit Courts of Appeals and the Board have held that other trusts filing returns for the year 1924 do not secure any relief under Section 704 (a) under such circumstances. *Gray* v. *Hopkins, supra; Commissioner* v. *Neal, supra; Sloan* v. *Commissioner, supra; Van Cleave Trust* v. *Commissioner, supra; Leszczynski* v. *Commissioner*, 29 B. T. A. 551; *Dutton* v. *Commissioner*, 18 B. T. A. 1151. See also *Landreth* v. *Commissioner*, 15 B. T. A. 655; *Dunbar* v. *Commissioner*, 65 F. (2d) 447 (C. C. A. 1st).

We submit, therefore, that Section 704 (a) has no application to this case.

CONCLUSION

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted.

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OCTOBER, 1935.

APPENDIX "A"

Revenue Act of 1924, c. 234, 43 Stat. 253:

SEC. 2. (a) When used in this Act—

* * * * *

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

* * * * *

(U. S. C., Title 26, Sec. 1262.)

SEC. 210. (a) In lieu of the tax imposed by section 210 of the Revenue Act of 1921, there shall be levied, collected, and paid for each taxable year upon the net income of every individual (except as provided in subdivision (b) of this section) a normal tax of 6 per centum of the amount of the net income in excess of the credits provided in section 216, except that in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 2 per centum, and upon the next $4,000 of such excess amount shall be 4 per centum;

* * * * *

(U. S. C., Title 26, Sec. 951.)

SEC. 211. (a) In lieu of the tax imposed by section 211 of the Revenue Act of 1921, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

* * * * *

(U. S. C., Title 26, Sec. 952.)

SEC. 212. (a) In the case of an individual the term "net income" means the gross in-

come as defined in section 213, less the deductions allowed by sections 214 and 206.

* * * * *

(U. S. C., Title 26, Sec 53.)

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * *

(U. S. C., Title 26, Sec. 960.)

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a

guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

* * * * *

(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

SEC. 230. In lieu of the tax imposed by section 230 of the Revenue Act of 1921 there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax of 12½ per centum of the amount of the net income in excess of the credits provided in sections 236 and 263.

(U. S. C., Title 26, Sec. 981.)

The corresponding provisions of the Revenue Act of 1926, c. 27, 44 Stat. 9, are identical except as to the rates of tax.

Revenue Act of 1928, c. 852, 45 Stat. 791, 880:

SEC. 704. TAXABILITY OF TRUSTS AS CORPORATIONS—RETROACTIVE.

(a) If a taxpayer filed a return as a trust for any taxable year prior to the taxable year 1925 such taxpayer shall be taxable as a trust for such year and not as a corporation, if such taxpayer was considered to be taxable as a trust and not as a corporation either (1) under the regulations in force at the time the return was made or at the time of the termination of its existence, or (2) under any ruling of the Commissioner or any duly authorized officer of the Bureau of Internal Revenue applicable to any of such years, and interpretative of any provision of the Revenue Act of 1918, 1921, or 1924, which had not been reversed or revoked prior to the time the return was made, or under any such ruling made after the return was filed which had not been reversed or revoked prior to the time of the termination of the taxpayer's existence.

(b) For the purpose of the Revenue Act of 1926 and prior Revenue Acts, a trust shall, at the option of the trustee exercised within one year after the enactment of this Act, be considered as a trust the income of which is taxable (whether distributed or not) to the beneficiaries, and not as an association, if such trust (1) had a single trustee, and (2) was created and operated for the sole purpose of liquidating real property as a single venture (with such powers of administration as are incidental thereto, including the acquisition, improvement, conservation, division, and sale of such property), distributing the proceeds therefrom in due course to or for the benefit of the

beneficiaries, and discharging indebtedness secured by the trust property, and (3) has not made a return for the taxable year as an association.

Treasury Regulations 65, promulgated October 6, 1924, under the Revenue Act of 1924:

ART. 1502. *Association.* — Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in corporate form is an association or corporation within the meaning of section 2, but if it continues its business in the form of a trust, it becomes subject to the provisions of section 219.

ART. 1504. *Association distinguished from trust.*—Holding trusts, in which the trustees are merely holding property for the collection of the income and its distribution among the beneficiaries, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, are not associations within the meaning of the law. The trust and the beneficiaries thereof will be subject to tax as provided in articles 341–347. Operating trusts, whether or not of the Massachusetts type, in which the trustees are not restricted to the

mere collection of funds and their payments to the beneficiaries, but are associated together in much the same manner as directors in a corporation for the purpose of carrying on some business enterprise, are to be deemed associations within the meaning of the Act, regardless of the control exercised by the beneficiaries.

T. D. 3749, IV–2 Cumulative Bulletin 6, promulgated August 31, 1925, amended Article 1502 of Treasury Regulations 65 by changing the last sentence to read as follows:

> A corporation which has ceased to exist in contemplation of law but continues its business in quasi corporate form is an association or corporation within the meaning of section 2.

T. D. 3748, IV–2 Cumulative Bulletin 7, promulgated August 31, 1925, amended Article 1504 of Treasury Regulations 65 to read as follows:

> ART. 1504. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by section 219 and by articles 341–347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 2.

> Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute.

Articles 1502 and 1504 of Treasury Regulations 69, promulgated under the Revenue Act of 1926, are the same as Articles 1502 and 1504 of Treasury Regulations 65, amended by T. D. 3749 and T. D. 3748, *supra*.

Articles 1312 and 1314 of Treasury Regulations 74, promulgated under the Revenue Act of 1928, are the same as Articles 1502 and 1504 of Treasury Regulations 69.

Article 1312 of Treasury Regulations 77, promulgated under the Revenue Act of 1932, is the same as Article 1312 of Regulations 74, but Article 1314 of Treasury Regulations 77 was changed to read as follows:

> ART. 1314. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by sections 161–170 and by articles 861–891. Where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but have similar or greater powers than the directors

in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the Act.

Articles 801–2 and 801–3 of Treasury Regulations 86, promulgated under the Revenue Act of 1934, are as follows:

ART. 801–2. *Association.*—The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Act, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

ART. 801–3. *Association distinguished from trust.*—The term "trust," as used in the Act, refers to an ordinary trust, namely, one created by will or by declaration of the

trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the

undertaking or arrangement is deemed to be an association classified by the Act as a corporation.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Act

disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences in detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

Treasury Regulations 62, promulgated under the Revenue Act of 1921:

ART. 1502. *Association.*—Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the members or shareholders on the basis of the capital stock which each holds or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the

organization. A corporation which has ceased to exist in contemplation of law but continues its business in corporate form is an association or corporation within the meaning of section 2, but if it continues its business in the form of a trust, it becomes subject to the provisions of section 219.

ART. 1504. *Association distinguished from trust.*—Where trustees hold real estate subject to a lease and collect the rents, doing no business other than distributing the income less taxes and similar expenses to the holders of their receipt certificates, who have no control except the right of filling a vacancy among the trustees and of consenting to a modification of the terms of the trust, no association exists and the cestuis que trust are liable to tax as beneficiaries of a trust the income of which is to be distributed periodically, whether or not at regular intervals. But in such a trust if the trustees pursuant to the terms thereof have the right to hold the income for future distribution, the net income is taxed to the trustees instead of to the beneficiaries. See section 219 of the statute and articles 341–348. If, however, the cestuis que trust have a voice in the conduct of the business of the trust, whether through the right periodically to elect trustees or otherwise, the trust is an association within the meaning of the statute.

APPENDIX "B"

DECISIONS OF THE CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

In the early case of *White* v. *Hornblower,* 27 F. (2d) 777, a stamp tax case, and in *United States* v. *Neal,* 28 F. (2d) 1022, reversing *per curiam* the decision of the District Court, 26 F. (2d) 708, certiorari denied, 278 U. S. 659, the Circuit Court of Appeals for the First Circuit apparently accepted the business test as conclusive. Again, in *Gardiner* v. *United States,* 49 F. (2d) 992, the court considered that the test was whether the trust was transacting business for profit. See also *Lansdowne Realty Trust* v. *Commissioner,* 50 F. (2d) 56; *Dunbar* v. *Commissioner,* 65 F. (2d) 447.

In some of its more recent decisions, however, it has rejected that test as decisive and has relied in part on whether the forms of a corporation were followed in the conduct of business. For instance, in *Commissioner* v. *Kelley,* 74 F. (2d) 71, the court held that a trust which was organized by members of a partnership conducting a glue business was not an association, though there could be no question but what the trust was transacting business just as the partnership had. In that case the court said that in some cases courts had emphasized form and in others whether the trust was carrying on a business, but that there was no law prohibiting the trustees from doing business and that there were two tests, namely, whether the association was

doing business and whether it followed the forms of a corporation.

To the same effect is *Coleman-Gilbert Associates* v. *Commissioner*, 76 F. (2d) 191, now pending in this Court on petition for certiorari, Nos. 78 & 79, October Term, 1935, in which the court said (p. 194):

> We think, however, it is generally agreed that, in order for a trust to be taxed as a corporation, the trustees must not only be carrying on a business enterprise for profit, but must be doing it in much the same manner and form as directors of a corporation.

DECISIONS OF THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The court applied the business test in *Allen* v. *Commissioner*, 49 F. (2d) 716, certiorari denied, 284 U. S. 655, concluding that the particular trust was merely engaged in holding securities for a limited time and purpose and was consequently not an association.

In *Ittleson* v. *Anderson*, 67 F. (2d) 323, a capital stock case, the court rejected the test of a quasi-corporate form and held that the trustees were engaged in sufficient activities for the trust to be taxed as an association.

See also *Investment Trust of Mutual Investment Co.* v. *Commissioner*, 27 B. T. A. 1322, affirmed *per curiam*, 71 F. (2d) 1009.

DECISIONS OF THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

In *Little Four Oil & Gas Co.* v. *Lewellyn*, 35 F. (2d) 149, certiorari denied, 280 U. S. 613, the court

stated that the theory that the distinction between trusts is based on the powers exercised by shareholders was no longer seriously regarded and that the test was whether the shareholders or trustees or both combined carried on a business for profit. It thus clearly emphasized the business test, although as a matter of fact some of the forms of a corporation were followed in the transaction of business by the trust.

That such was the conclusion of the court is settled by its decision in *Smith* v. *Commissioner,* 69 F. (2) 911, certiorari denied, 293 U. S. 561:

See also *Harmer Coal Co.* v. *Heiner,* 34 F. (2d) 725 (a capital stock tax case), certiorari denied, 280 U. S. 610.

DECISIONS OF THE CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

In *Blair* v. *Wilson Syndicate Trust,* 39 F. (2d) 43, the court held that the trust was a pure trust and was not an association, and in doing so apparently distinguished between an ancestral trust and a voluntary trust. Nothing very clear was said in that case on the subject of the necessity of corporate form.

In *Lucas* v. *Extension Oil Co.,* 47 F. (2d) 65, the court emphasized the lack of resemblances to a corporation and concluded that the trust was neither in business nor had such corporate structure as brought it within the definition of an association.

In *Commissioner* v. *Guitar Trust Estate,* 72 F. (2d) 544, a husband and wife created a trust for the benefit of their children and conveyed most of their property, including a variety of business

enterprises, to it. In that case the court emphasized both the lack of control by the certificate holders and the lack of resemblances to a corporation, and said that the fact that the duties of the trustee included carrying on a going business was not material. Cf. *Gray* v. *Hopkins,* 68 F. (2d) 561, certiorari denied, 292 U. S. 643, which, however, turns largely upon the application of Section 704 (a) of the Revenue Act of 1928. See also *Commissioner* v. *Commercial Trust Co.,* 56 F. (2d) 1080, reversing *per curiam* 21 B. T. A. 732.

DECISIONS OF THE CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The decisions of this circuit do not appear to be entirely consistent, although in general the court has considered that it is necessary for some corporate attributes to be present.

In *Sears, Roebuck & Co. Employees' Savings, etc.,* v. *Commissioner,* 45 F (2d) 506, it was held that an employee's savings and profit sharing fund was taxable as an association, although there were no certificates of beneficial interest and a number of other attributes of a corporation were lacking.

In *Tyson* v. *Commissioner,* 54 F. (2d) 29, the court apparently relied on the absence of corporate forms and on the absence of beneficiary control, as well as upon the lack of business activity.

In the later case of *Tyson* v. *Commissioner,* 68 F. (2d) 584, certiorari denied, 292 U. S. 657, involving a different real estate trust, the court found that the trustee was engaged in enough activities to amount to carrying on a business, but it also relied upon the existence of certain corpo-

rate attributes including transferable certificates and the resemblance of the trustees to a board of directors. See also *Commissioner* v. *Duckwitz*, 68 F. (2d) 629, and *Commissioner* v. *McCormick*, 68 F. (2d) 653.

In *Commissioner* v. *Morriss R. Co. Trust No. 2*, 68 F. (2d) 648, the court held that the activities engaged in were not sufficient to constitute an association and apparently regarded that as the more important test, although it mentioned the lack of corporate organization.

In *Reinecke* v. *Kaempfer*, 72 F. (2d) 469, certiorari denied, 294 U. S. 708 (involving a capital stock tax), the court again considered it necessary that there should be resemblances to a corporation but emphasized resemblances in substance rather than in form.

In *Swanson* v. *Commissioner*, 76 F. (2d) 651, which is now pending before this Court on petition for a writ of certiorari, No. 108, October Term, 1935, two individuals owning an apartment building transferred the property to three trustees to manage. One half of the original shares of beneficial interest went to each grantor, but they were subsequently transferred to their wives. The record showed that the trustees did not have formal meetings and left everything to one trustee, who was a partner in another business. The court apparently emphasized the business test and to the extent that it paid any attention to corporate structure seems to have emphasized resemblances in substance rather than form.

The decisions of the Circuit Court of Appeals for the Ninth Circuit are more consistent, generally speaking, than those of any other circuit with reference to this question.

In the case of *Trust No. 5833, Security-First Nat. Bank* v. *Welch,* 54 F. (2d) 323, certiorari denied, 286 U. S. 544, the court stated that the real test was whether the shareholders or trustees or both combined carried on business for profit and that it was immaterial whether the shares of interests in the project were evidenced by certificates of stock.

To the same effect is *Commissioner* v. *Atherton,* 50 F. (2d) 740, where it was held that the trust was not an association because it was organized by a transit company solely for the purpose of liquidating its real estate holdings and that it did no business except to collect rent and pay taxes on the parcels involved until the land was sold.

In *Sloan* v. *Commissioner,* 63 F. (2d) 666, the business test was again emphasized and it was held that the trust was an association because it had originally been organized to lease, mortgage and sell lands in a subdivision, even though all of the lands had been sold and during the taxable year involved the trustees' activities were limited to the collection and distribution of installment payments. See also *Willis* v. *Commissioner,* 58 F. (2d) 121.

Again, in *Twin Bell Oil Syndicate* v. *Helvering,* 70 F. (2d) 402, reversed on other grounds, 293 U. S. 312, the court said (p. 407):

There is ample additional authority for the proposition that the "business" test is now paramount.

The decision in the *Morrissey* case, therefore, is in accord with the general trend of decisions in the Ninth Circuit. In one case, however, that of *Commissioner* v. *Combs,* 76 F. (2d) 682, which is now pending before this Court on petition for a writ of certiorari, No. 238, October Term, 1935, the court departed from the view that the business test was paramount and held that the trust must also use the corporate method of transacting business in order to be taxed as an association. This decision is clearly contrary to the court's previous decisions, none of which it expressly overruled.

DECISIONS OF THE CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

In *Commissioner* v. *Brouillard,* 70 F. (2d) 154, certiorari denied *sub nom., Helvering* v. *Pryor & Lockhart Development Co.,* 293 U. S. 574,* the court defined an association as a body of persons united without charter but employing the methods, modes and procedural forms of a corporation, and suggested that the resemblances to a corporation should be balanced. The court definitely rejected the claim that the doing of business was sufficient.

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* One of the syndicates before the court in this case was also before the court in *Commissioner* v. *Duckwitz, supra.* The same syndicate was before the Circuit Court of Appeals for the Eighth Circuit in *Burnet* v. *Burns,* 63 F. (2d) 313, where the court held that it was a joint venture. We have not discussed the decisions of that Circuit as that case is the only one on the subject and it does not lay down a clear test.

The Board's decisions cannot be reconciled. In the following cases it apparently has emphasized the test of "doing business" without regard to quasi-corporate form. *Woodrow Lee Trust* v. *Commissioner*, 14 B. T. A. 1420; *Dauphin Deposit Trust Co.* v. *Commissioner*, 21 B. T. A. 1214; *Carlson* v. *Commissioner*, 27 B. T. A. 93, now pending in the Circuit Court of Appeals for the Ninth Circuit; *Tulsa Mortgage Investment Co.* v. *Commissioner*, 21 B. T. A. 735; *Dutton* v. *Commissioner*, 18 B. T. A. 1151.

In the following cases the Board accepted the necessity of there being a resemblance to a corporation in mode of procedure. *Sturgeon* v. *Commissioner*, 25 B. T. A. 368; *Cyclops Iron Works* v. *Commissioner*, 25 B. T. A. 603; *Jackson-Wermich Trust* v. *Commissioner*, 24 B. T. A. 150; *Dolese & Shepherd Co.* v. *Commissioner*, 30 B. T. A. 1171,

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